IN THE UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF TEXAS
TYLER DIVISION

VIRNETX, INC.)
DOCKET NO. 6:13cv211
-vs-)
Tyler, Texas
) 1:30 p.m.
APPLE, INC. August 15, 2013

TRANSCRIPT OF MOTION HEARING
BEFORE THE HONORABLE LEONARD DAVIS,
UNITED STATES CHIEF DISTRICT JUDGE

A P P E A R A N C E S

(SEE SIGN-IN SHEETS DOCKETED IN THE MINUTES OF THE HEARING.)

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SPEAKERS

FOR THE PLAINTIFFS:

MR. BRADLEY W. CALDWELL
MR. JASON CASSADY

FOR THE DEFENDANTS:

MR. ERIC ALBRITTON
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P R O C E E D I N G S

THE COURT: Please be seated.

All right. Ms. Ferguson, if you will call the case, please.

THE CLERK: Court calls Case No. 6:13cv211, VirnetX, Inc. v. Apple, Inc.

THE COURT: Announcements.

MR. CALDWELL: Your Honor, good afternoon. Brad Caldwell on behalf of the plaintiff, VirnetX. I would like to introduce the CEO of VirnetX, Mr. Kendall Larson, who is with us here today. Also, is Jason Cassady and Austin Curry from my firm. Mr. Pearson back there. And Charlie Ainsworth.

THE COURT: Thank you.

MR. CALDWELL: Plaintiff is ready, Your Honor.

THE COURT: Thank you.

MR. ALBRITTON: Good afternoon, Your Honor. Eric Albritton, Danny Williams, Matt Rodgers, Drew Kim for Apple; and we are ready.

THE COURT: Okay. Very well. Anybody else wish to enter an appearance?

All right. We're here on the issue of ongoing royalty, and the Court will hear from VirnetX first.

MR. CASSADY: One moment, Your Honor.

(Pause in proceedings.)

MR. CASSADY: May it please the Court?

THE COURT: All right.

MR. CASSADY: As the Court is aware, we are here to discuss the ongoing royalty request by VirnetX in the VirnetX/Apple case. So just to get started, I think nobody is surprised by a quote like this about ongoing royalties but: An ongoing post-verdict royalty is appropriately higher than the jury's pre-verdict reasonable royalty.

So what we are here today to ask the Court is to assess a higher royalty on the post-verdict royalties for the use of VirnetX's technology by Apple.

Now, before we get into a number of issues that both parties disagree with one another on, I'm hoping --

THE COURT: And y'all have had no progress as far as resolving this by agreement?

MR. CASSADY: We have attempted to resolve by agreement. I'm not going to point any fingers. We haven't resolved. That is about the best I can tell you, Your Honor.

My next slide, though, so I can show you -- I am hoping Mr. Williams can tell me he does agree with this. Based on the pleadings in this case my understanding is these three issues are not contested by the parties.

The first one is that the jury award calculates out to a .52 percent running royalty. That was done based on Mr. Weinstein, VirnetX's expert's royalty and the finding of the jury. And that is the number that both parties in this

case have used to assess what the royalty should be in a future royalty context.

Additionally -- and I apologize for the wordiness of next couple of bullets, Your Honor, but I will break it down. The second bullet point basically says that all products until April 5th are still using both functionalities.

So up until April 5 of this year, iOS and Mac products used the features that were in this case. So all the iOS products that used VPN on Demand and FaceTime that were still in this case. And then the Mac products used FaceTime up until April 5th, 2013.

The third bullet is a little more simple. That one is that all Apple iOS products are still using today the VPN on Demand feature that was adjudicated in our case.

So the point of that is to inform the Court of kind of the dates where one feature may have become contested with regards to whether or not it infringes; whereas, the VPN on Demand is staying uncontested at being used exactly the same way it was in the verdict until the design-around happens, it sounds like sometime in September, by Apple; at least that is what we are hearing from them right now.

So I wanted to give that Bedrock to Your Honor to start from because that is kind of where both parties jump off of for their negotiation in the hypothetical negotiation.

THE COURT: Okay. Do you agree that they have

achieved a design-around on the non-iOS devices.

MR. CASSADY: Actually, no, Your Honor. Right now VirnetX is in the position of not having the discovery it needs for both the relay scenario and for the VPN on Demand scenario in order to totally understand whether or not those non-infringing alternatives are truly non-infringing alternatives and are not somehow -- fall under the not colorably different standard. We are seeking that discovery.

For instance, we subpoenaed Akamai which runs the relays, and we have asked Apple to give us the beta source code for their VPN on Demand design-around. That discovery is still ongoing. It is still part of the process. We are not really here to ask the Court to adjudicate those non-infringing alternatives.

What we are actually here to talk about is just the royalties that would apply, you know, if and when those rates may -- if and when those non-infringing alternatives were to come into being.

THE COURT: So you are saying that what you are here to argue today is what the rate should be, assuming and until -- assuming for whatever period of time that you do not agree that a non-infringing alternative has been implemented?

MR. CASSADY: I think that is fair. I think, Your Honor, I think our position is whether or not they implement a non-infringing alternative, the rate is the rate.

If they do initiate one, they don't pay. If they don't initiate one and the Court finds that it is not more than colorably different, then they pay the rate the Court previously determined.

So rather than kind of stall out fighting about the non-infringing alternatives that are not fully implemented or there is still ongoing discovery on, we thought the rate was appropriate to talk about now.

THE COURT: Okay. So you are not -- your position is that the rate should not change, depending upon whether they do or do not have a non-infringing alternative; that if they have a non-infringing alternative, then the rate just doesn't get applied to that revenue stream?

MR. CASSADY: Yes, Your Honor. What we would say that if a product has a functionality in it that has an accused functionality that is infringing, then the rate applies. And if it doesn't have one, it doesn't. But we are not here to talk about whether some feature falls in and out of that right now.

THE COURT: And that will either be decided by agreement between the parties, if it can be agreed, or by motion of the Court by one party or the other to -- for it to apply or not apply?

MR. CASSADY: Yes, Your Honor. That is mainly because of the infancy of these design-arounds. We are in the

scenario where we just don't have the eyeballs on the exact source code and exact versions that are going to happen.

Rather than wait a month or two months to get the discovery and start the process, we decided it was better to get in front and let's determine the royalty and talk about the non-infringing alternatives later.

THE COURT: Okay. Mr. Williams, not to put you on the spot but just to see if we are all on the same page here, do you agree or disagree that these three issues that he has put on the screen are not contested?

MR. WILLIAMS: I do not agree. There are some contests here. We are not disputing the .52 percent calculation for the purposes of the ongoing royalty because we believe that is -- if you take what the jury awarded by the revenue stream, that is what it comes out to. We think that the case law says that is the appropriate starting point for determining the ongoing royalty post-judgment.

THE COURT: The 3.1 (sic) then --

MR. WILLIAMS: With the caveat that we have stated in our papers, and that is we don't think that number is correct; and that will be the subject of the appeal that we have made.

THE COURT: Right.

MR. WILLIAMS: But subject to that caveat, that is correct.

Now, with respect to the second two bullet points I would say -- with respect to the second bullet point, the FaceTime, he is including non-adjudicated products released later.

Now, the Court made very clear -- in fact, there was a dispute between -- well, I don't know if it is was really a dispute -- but before the trial in this first case VirnetX would not indicate whether, for example, iPhone 5 was in the case or not. They just wouldn't make the statement. We had that argument here in the courtroom. And the Court stated specifically iPhone 5 is not in that case.

So what we think is appropriate for this ongoing royalty -- by the way, when VirnetX filed its follow-on case the night of the verdict and they have since given us infringement contentions, they are including all those products; that is, the later released products in the subsequent case. And we think those are most appropriately to be kept there.

Now, there is not necessarily a clear line between the product and iOS depending on the feature that you are talking about, but that is how they have sought to structure their cases. So what we would say on the second bullet point is it would be the products that were adjudicated as infringing that are used in FaceTime, up until the April 5th, 2013 date, which is when Apple fully went to the 100

percent relay.

Now, let me say that in response to what Mr. Cassady said, they have, in fact, gotten the source code for that relay, all related to design-around. In fact, it was produced in a parallel ITC case and then subsequently produced in this ongoing royalty proceeding when they asked for it. So they have had that source code and they have been able to determine whether they are going to say that it is infringing or not.

Now, we know in spades -- and we are going to cover this in my presentation, that the Court itself recognized they conceded that the relay calls are not, in fact, infringing.

So the point that I would make on the second bullet is, number one, the non-adjudicated products released later should be a part and, in fact, are a part of the second case already. And I'd say let's leave those there. Let's deal with the products that are adjudicated as infringing in the first trial, and let's figure out what the ongoing royalty for those products should be.

And that is true. The April 5th date would be the cutoff date on that for FaceTime royalty.

The third Apple iOS devices, that, again, addresses the question of whether we should rope in products that were not adjudicated as -- in the first case. We would

say, again, let's deal with the products that were subject to the first case. They have interjected these later products, the other products into the second case. Let's let that play out the way it should be played out.

And, in fact, in terms of a non-infringing design, I will address that a little bit more later; but we have given them documentation to suggest what that will be. It is not, in fact, a final design at this point, so we don't have final source code to produce to them. But, again, that is a part of the follow-on case and should be dealt with in that case.

THE COURT: All right. Mr. Cassady, let me ask you to reply to the major difference it sounds like that y'all have; and that is whether the non-adjudicated products should be included in this case or in the subsequent case.

MR. CASSADY: Your Honor, I am actually quite shocked about that. The iPhone 5 is the main product that we are talking about. There are other variations of the iOS products, but the iPhone 5 is mainly what we are talking about.

In the briefing, both our primary brief and our reply we said Apple should not get away with not paying on iPhone 5 because it is exactly the same product unless they were to show otherwise.

And the scenario we were in was in the response they didn't respond to that, and in their surreply after we

entered our reply, again, said they are not contesting that similar products should not be included in the base. They, again, in the surreply didn't contest it. So candidly, Your Honor, I didn't come here prepared to argue that because it was a non-issue in the briefing and I assumed we were done --

THE COURT: Is that the only non-adjudicated products that you are referring to in your slide are the iPhone 5 products?

MR. CASSADY: It is the iPhone 5 and the updated iPad and the iPad mini. That is the general category of products is those three.

THE COURT: Response, Mr. Williams?

MR. WILLIAMS: Yes, Judge. I don't believe that Mr. Cassady is entirely surprised, he would be shocked. I would raise this point because if you look at what his own expert submitted -- or they submitted by their expert in this ongoing royalty case, his own expert did not include iPhone 5.

MR. CASSADY: Let's just ask a different question, Mr. Williams: Does the iPhone 5 FaceTime work differently than the other products in this case?

MR. WILLIAMS: Well, let me say two things, Your Honor, and I will speak this to the Court.

First of all, if it works exactly the same as iPhone 4, then we are not going to be in the second case,

subject again to the appeal of the first case. We are not going to be contesting whether it infringes, but let me put it this way:

We are not going to contest in the second case, which is ongoing at this time, an identical functionality that was accused of infringement -- or even basically the same functionality that was accused of infringement. We are not going to argue that again, subject to the appeal again.

But, secondly, I would say that this Court said, in fact, that product is not in the case. And the reason the Court took that position, Your Honor, is because VirnetX refused to accuse it prior to the trial. We had that discussion. Mr. Cassady and I had that very discussion as we stood here, before this Court.

I asked him, are you accusing iPhone 5? We need to know. You are the plaintiff. He refused to take a position, and the Court said iPhone 5 is not in this case. So they have chosen to structure their cases, for whatever reason, the way they are structured. I think we follow that structure and it keeps things much simpler, frankly.

THE COURT: Response?

MR. CASSADY: Your Honor, I didn't -- in the hearing arguing that, I did not say that iPhone 5 is not more than colorably different than the rest of the products. I didn't say that the iPhone 5 could never be part of any

functionality that was in this case.

What I said was that they had refused to give us the discovery on it, so we were in the blind in the trial where they could get up and say whatever they wanted without cross on how it worked, and we wouldn't know. And to this date in the motions they made it clear they are not contesting the iPhone 5 works the way the other products do. That is why we are saying it should be included. And like I said, the reason I am surprised is if they really thought it worked differently, they would have said it in the briefing. Now I think they are just coming in to say something different.

Candidly, Your Honor, I don't want to get bogged down to this issue, but it is an important one. I guess what I would ask from Mr. Williams -- I think my client would be okay with this.

You are saying you are not going to argue about the infringement of the iPhone 5 in the new case if the appeal goes right, but what about the royalty rate? If Judge Davis gives a royalty rate, are you going to contest that rate in that upcoming trial? If you can say you are just going to live with what is here, I think we may be able to work that out.

THE COURT: Well, y'all can meet and confer and discuss that.

But I guess, Mr. Williams, I do have a question whether the functionality of the iPhone 5 is colorably

different than the functionality that was proven at trial? Do you have a position on that at this time?

MR. WILLIAMS: Your Honor, I don't think I have an official position on that. When we asked them in the beginning -- I mean the iPhone 5 came out, if you will recall, shortly before the trial.

THE COURT: Right.

MR. WILLIAMS: Not too long. Hence, the problem. Of course, it was well after discovery. The question was, should we provide discovery on an accused product? We couldn't get a straight answer out of them. They just wouldn't take a position. And so this Court said it was not in the case. So as far as we were concerned it was a dead issue at that point.

MR. CASSADY: Your Honor, not to beat a dead horse -- I think we are getting there. But the data that they just produced to us in the 211 case in this matter about future royalties, included the iPhone 5 in the data. So they clearly thought it was.

THE COURT: Let's go on with your argument. I think we know what y'all do agree on and what you don't agree on.

MR. CASSADY: Thank you, Your Honor.

So, basically, we ran through a George-Pacific and Read analysis in the briefing. And, Your Honor, I don't

want to belabor by going through every little factor for Your Honor. What I do have is a number of issues that I would like to talk to the Court about today that may or may not fall in the Georgia-Pacific factors, but I think they are more important to focus on those than to walk through the factors. I think you can rely on the briefing for those.

With that I think this is really a question of fundamental fairness, Your Honor. And here in front of us is the three large reasons that VirnetX believes that the reasonable royalty should be enhanced and should be enhanced to a large amount.

The first one is, the case we are in now we have a verdict and we have a judgment, we had a finding of validity on the patent in that case. Unlike other cases, we actually have a finding of validity in two other trials related to these patents that aren't Apple's but other defendants.

And so in this case, as usual, it is the case that, absent unusual circumstances, a defendant's continued infringement after it is an adjudicated infringer, is willful even before appeal. This is because a defendant is acting in the face of an unjustifiably high risk of harm if it continues to infringe in light of a jury verdict and judgment of infringement. So we contend that Apple is willful.

Now, one of Apple's positions is that we didn't accuse Apple of willful infringement in the jury trial and,

therefore, we can't piggyback off of our verdict in order to get willfulness after the trial.

Your Honor, the Mondis case that is right in front of us still goes right to that point. In that case, the case went to trial with the willfulness on the verdict form, and the jury found willfulness. But Judge Ward actually took -- in that case Judge Ward JMOL'd the willfulness finding and said there wasn't enough evidence of willfulness prior to verdict.

But still in assessing the future royalty, Judge Ward assessed willfulness against the defendant in that case. And so what Judge Ward said was even if you don't have willfulness before, you are absolutely willful after a judgment and a verdict in a case. And here we talk about -- this is, again, a quote from Mondis, Apple -- again, I am just supplementing the defendant here.

Apple would have the Court effectively adopt a standard that a party is not a willful infringer until after it has resolved all its rights on appeal and has lost. Implicit in this argument is Apple's obvious lack of respect for the jury's verdict or the Court's judgment.

And, Your Honor, I think that is a situation we have here is that Apple is arguing they have some other defenses that are down the road and, therefore, they are not willful. And I think the District and Fed Circuit has kind of

dealt with this issue, and willfulness is usually found after a jury finding and after a judgment. But Apple contests that. That is why I wanted to talk about that a little bit with Your Honor. So that is the willfulness issue with regards to the appeal.

But then they also say we have the reexams.

Let me skip forward a little bit.

They say we have the reexams. So, again, I went to find the cases in this district. Here is another one: The Court rejects the contention that Apple's continued infringement is not willful merely because the asserted claims in the patents have been rejected in the pending reexams.

Again, Your Honor, we have got three juries have said these patents are valid; or at a minimum have found them not to be invalid. Then in addition, we have the one in this very case, and the pending reexams are basically another what I call excuse as to getting out of the willfulness.

At this point they have got a jury verdict and judgment and they are willful. And Your Honor I believe -- in the next slide -- Your Honor has found the same holding in the Fractus case just a couple months ago.

Your Honor, that leads me to the second point I had, which was the licenses that are -- Your Honor --

There you go.

That is the holding I really wanted you to read.

I apologize, Your Honor.

And so the next point I have here -- Your Honor, are you done with that slide?

THE COURT: Yes.

MR. CASSADY: I don't want to interrupt you.

The next slide has to do with, again, fundamental fairness of the licensees that have come before and after Apple. This in front of you is a chart that shows the average future royalty on top, for the licensees that have future royalties. And just for Your Honor's sake of full disclosure, I gave you the average, including Microsoft at the bottom using their effective royalty rate.

As Your Honor is aware, there is another case outstanding against Microsoft for the breadth of infringement they have with regards to VirnetX's patents. So, therefore, Microsoft's effective royalty is actually not the whole story; but I put it in there anyways to show Your Honor that the licensees that have come before Apple and after -- Siemens and Avaya are both after the verdict in this case -- have all given royalty rates that are much higher than the rates that effectively came out of the jury in this case.

THE COURT: How did those parties compare, you know, from a royalty base standpoint?

MR. CASSADY: From a volume basically?

THE COURT: Yeah.

MR. CASSADY: Your Honor, Astra, Mitel, and NEC were relatively smaller, relatively smaller. Siemens was relatively smaller. But the most recent one, Avaya, Avaya was on a larger magnitude -- I don't want to seal the Court right now, Your Honor. I don't know if I want to approach or just tell you, but we did submit the license to you. I didn't want to give out the number, but they are much larger than the other licensees. They are smaller than Apple.

I mean, obviously, Apple is the second largest company in the world. So they are smaller than Apple. I would say Avaya was, you know, decently smaller than Microsoft; but much bigger than the other licensees. And, candidly, Your Honor, Avaya signed that license after what we believe to be Cisco's inappropriate arguments won that jury trial back in March. Avaya still agreed to the royalty rates that VirnetX proposes out there. So, really, we think it is one of those fundamental --

THE COURT: What percentage of Apple's volume would you say Avaya is?

MR. CASSADY: The volume -- just a royalty base -- if I do the numbers -- let me -- give me one second in my head, Your Honor.

(Pause in proceedings.)

MR. CASSADY: Your Honor, I would say -- I mean, I would say Avaya may be ten percent of Apple.

THE COURT: Okay. Thank you.

MR. CASSADY: Yeah. Depending on how you calculate it, but I think that is about right. Microsoft would be clearly the larger in between both -- in between Avaya and Apple. And so Siemens and Avaya, like I said, were after that trial; and their rates were much larger.

So we are in the scenario here where we have a situation where companies that have the same argument Apple did, they contended the patents were not infringed, they contended they were invalid, they contended everything that Apple did, and in some cases more than Apple did; and they all voluntarily signed up for these licenses for these rates.

And Apple comes in here after losing a verdict and losing on judgment and wants to get a rate that is fractional of these rates.

THE COURT: Write on a piece of paper what their rate is and pass it up to the Clerk.

MR. CASSADY: Whose rate are you looking for?

THE COURT: Avaya.

MR. CASSADY: Avaya. Yes.

THE COURT: Show it to opposing Counsel.

MR. CASSADY: I will, Your Honor.

(Pause in proceedings.)

THE COURT: That will save us having to clear the courtroom.

MR. CASSADY: I'm sorry, Your Honor?
THE COURT: That will save us having to clear the courtroom.
MR. CASSADY: Fair enough.
(Pause in proceedings.)
MR. CASSADY: My handwriting -- I'll just make the number a little more defined. I will show you again because my handwriting is off a little bit.
(Shows opposing Counsel the document.)
MR. CASSADY: May I approach, Your Honor?
THE COURT: Yes, you may.
MR. CASSADY: My wife always yells at me about my handwriting.
(Shown to the Court.)
THE COURT: Thank you.
All right.
MR. CASSADY: So, again, Your Honor, with regards to those parties who voluntarily signed licenses, their voluntary rates are higher than both what the jury put forward and what Apple is suggesting should be the rate in this case.
And, again, I will say that these parties all had the same defenses, they were all in the same position. Obviously, Microsoft was in the position of having a verdict against them as well.
THE COURT: Let me ask you another question: Is

Avaya doing any type of design-around?

MR. CASSADY: My understanding is, no, Your Honor. My understanding is they are going forward, and they are going to use the features.

THE COURT: Okay. Thank you.

MR. CASSADY: Candidly, Your Honor, I don't know what their design-around would be. So the point is, in the process of mediating with them, I'm not aware of anything in them telling us they are going to go around the patents.

THE COURT: Okay.

MR. CASSADY: And then, again, Your Honor, I go back to the point of the before and after. So Astra, Mitel, NEC, and Microsoft were before the jury; and Apple makes a big deal that that is already baked into the royalty rate that came out of the jury verdict.

Two points to that, Your Honor. One, Siemens and Avaya were both after the verdict. Those rates were -- what they are, Your Honor has one of them in front of him. The Siemens' rate was very similar to that rate; not the pre-volume but the rate they agreed to.

Also, Your Honor, it goes to my next point is that -- the third point, which is what I would consider the false non-infringing alternative data. What I would tell Your Honor on a high level is these royalties here are the royalties that VirnetX's patents demand. That is what those royalties

are.

The .52 percent that came out of the verdict, that, I believe, has been toxified or lowered by the false data that was provided regarding Apple's non-infringing alternatives. And I can point you to some specifics, Your Honor. Here is one piece of testimony crossing Mr. Weinstein, VirnetX's expert. And he was being asked:

If those costs of Apple implementing its relay FaceTime non-infringing alternative were, let's say, 5 million, do you think that a rational company would pay 700 million for something they can do for 5?

Then Mr. Weinstein answered: If those costs were five, I would have expected them to have done it by now.

Now, you know, Mr. Weinstein's response was a little cheeky, but the point is they go in front of the jury and they tell the jury it is 5 million dollars to design around this system and our patents aren't worth anything.

And the whole story he told at trial was about how our patents weren't worth much; they were one of a tiny, tiny feature in a big ecosystem and we could design around them because we are Apple, and it is cheap.

They use that in regards to VPN on Demand, as well. Your Honor noted in the judgment that Apple had contended one thing in front of the jury and contended one thing after, when we got to the injunction stage of the trial.

Your Honor, what I would tell you now is it is a lot worse than it was when we were doing the injunction hearing. Here is a couple of things I want to show you.

Here -- you can see the number on the bottom right is the 50 million dollar payment that Apple made to Akamai for a 20-month term or a 21-month term on their relay servers for a very specific amount of bandwidth. I think it was 125 gigabits, Your Honor.

So that comes out to -- I did the math up at the top -- comes out to $2,422,000 a month. So they sat in front of this jury and told them 5 million dollars; and under that math right there, 5 million dollars gets them two months, in two months. And, Your Honor, we were talking about a feature that was years old at that point when we were in trial, so that is years of amount of money that we would have to spend to relay around --

THE COURT: And this figure, the 50 million fees, that is for how many months?

MR. CASSADY: That is for 21 months, Your Honor.

THE COURT: For 21 months of --

MR. CASSADY: Of relay.

THE COURT: -- of relay service.

MR. CASSADY: But what is important, Your Honor, is that is at the 125 gigabits. So that is 125 gigabits. So

that is assuming they don't ever climb over that number, it wouldn't get any more expensive.

Your Honor, this was renegotiated with Akamai after the verdict. So this number probably would have been higher if it would have been a number of years ago. But the point is, that is the number that we know they are paying. We know they paid that number.

But it gets more interesting than that, Your Honor. So here is an email we just recently received -- we have been asking for this discovery, and we have been having a hard time of getting ahold of it. We finally got ahold of stuff, and here is one of the emails. The gist of this email is this is Akamai emailing Apple and telling Apple that by the end of this month they need to be up to at least 150, and by the end of the year they need to be up to 250 gigabits.

So what Akamai is telling Apple is, this is an ever-increasing problem. This relay solution is not going to be easy. It is not going to stay as low. It is going to be ever changing and ever getting more expensive.

And we have another piece of data, Your Honor, to show, this is what Apple has to pay in addition to that 50 million dollars in order to meet up with the gigabits that they need.

So just here, Your Honor, for example, up to 250 gigabits -- which it looks like they are going to get to in a

couple of months, up to 250 gigabits is another 3.2 million dollars a month on top of the 2 million a month they already had.

So we are talking about one month is the number they told the jury was the life of the relay, non-infringing alternative. Five million a month is what they are going to start spending. And they told the jury it was 5 million dollars in total to do this non-infringing alternative.

So -- but it doesn't end there, Your Honor. So now we've got more information from them about their projections for what the relay servers are going to look like next year.

This is a slide here, Your Honor.

It is a little hard to read up here; but the gist of it is, there is a little green line underneath all those bars on the bottom. That is their current capacity. They think in the next -- in the next year, in 2014 that their capacity is going to jump up to a minimum of 300; and if you look at the top, Your Honor, up to possibly a terabit of data they are going to need on a monthly basis; a terabit.

So they are going to need a terabit of relay data. I'm sure they will get a volume discount. But I know it is going to be more than 5 million. It is probably more than 10 million. It may be more than 20. But the point is it is not five in total.

So the reason I bring all that up and back to fundamental fairness is, whether or not the licenses were in front of the jury, this toxic information was in front of the jury. At best it was either just a huge mistake; and at worse a fabrication. And that is a scenario we are in. Those were put in front of the jury, and the licenses were drawn down in rates because Apple got to go in front of the jury and say this feature is not important.

I mean, Your Honor, if I was in front of that jury arguing this again today with this data, I don't think damages would be much of a question in that case. The jury hears that Apple's only non-infringing alternative is going to cost them millions and millions of dollars a month and it is only going to get worse over time, I don't think a jury starts questioning the licenses at that point.

I think a jury looks at that and says -- even Apple says this is expensive, so it must be important; and it changes the way that a jury sees that.

THE COURT: Remind me what was argued at the injunction stage.

MR. CASSADY: At the injunction stage, Your Honor, it was -- I want to say it was a couple million dollars a month number. And it wasn't any more than that. Basically, it was the contract price of 50 million and not the increases that are now going to start occurring because the feature is

more and more popular with regards to the bandwidth it needs.

As they add more devices, they add more people, they need more volume.

THE COURT: Okay.

MR. CASSADY: And so, Your Honor, that is actually not the whole picture though. So they also told the jury that nobody cares whether this relay -- the relay works just as well as direct. It doesn't matter.

Your Honor, I will tell you as a person who uses FaceTime, it has gone downhill since they went to all relay.

THE COURT: Wait a minute. Do you want to be put under oath?

MR. CASSADY: No, Your Honor, I don't. That's why I brought you some evidence. So just last night, just last night -- or maybe it was the night before last, one of my colleagues -- I won't put him on the stand either, was on a call on FaceTime and it did this (indicating). This is reconnecting.

You will notice, Your Honor, up on the top right there is still some color, so one connection is still there; but the relay has lost one side of the video feed.

I will tell you, Your Honor, I am fairly confident this happens a lot since the relay server has happened. Dr. Jones at the trial kind of made a couple references to possible delays in the connections, but we didn't

go as far as to explain to the jury what we thought the massive problem with the relay servers would be, other than the volume and expense. And these kind of things are starting to show up.

Your Honor, we tried to get some discovery on FaceTime to bring in front of Your Honor on this issue, and we had some discovery disputes about an AppleCare database, that is, the phone calls into Apple complaining about FaceTime. At this point it sounds like Apple and I -- we have agreed to get access to that database.

But, Your Honor, candidly, I haven't been able to see that database other than for maybe 30 minutes at one point. And it has got over 500,000 entries in it.

So my hope is to bring in front of Your Honor more complaints from that database -- I am pretty sure they are in there -- regarding the functionality of FaceTime.

While a user may not understand that it is the relay causing this, he will understand or she will understand that it is disconnecting on them; that it takes longer to connect; and that it is just not working as well. So that is with regards to FaceTime, Your Honor. But it doesn't stop there.

So during the injunction stage, Apple told the Court that they were designing around VPN on Demand, and then they put out this press release.

I will step away from that and try to speak up.

They put out this press release, and they basically skewer VirnetX: Due to a lawsuit by VirnetX, Apple will be changing the behavior of VPN on Demand for iOS devices using 6.1 or later.

THE COURT: I'm sorry. I can't hear you.

MR. CASSADY: I will step back to the mic, Your Honor. It says: Due to a lawsuit by VirnetX, Apple will be changing the behavior of VPN on Demand for iOS devices using 6.1 and later iOS.

And then it goes on to say they are going to remove the OAS, which has been the issue of the case with regards to -- excuse me -- with regards to VPN on Demand.

That was during the injunction stage of the litigation -- or of the pleadings.

Well then, 20 days later, Your Honor, after -- which was after Your Honor denied the injunction request, we got this one: Apple no longer plans to change the behavior of the VPN on Demand feature of iOS 6.0 for devices that have already been shipped.

So now they are not going to change it.

I am not faulting them for saying they are going to change it and then deciding not to change it because an injunction may come down. But, again, this is one of those issues where they told the jury it would take five minutes and we would just remove that little functionality and nobody would

care. Then when it came time to put your money where your mouth is, they are not interested in making that change.

Now, there has been seven iOS updates since the verdict; and that feature hasn't changed; seven. And they are saying that the next update they are going to put out is going to change it. I understand that is to be in September.

Your Honor, sitting here today I actually believe that, based on just supposition of what they are telling me they are going to do, we are pretty sure it is not more than colorably different and it is going to be infringing. But -- that we haven't seen the code, we haven't seen enough to really understand that. So the point is, it is still not out. That is not coming out until September at the earliest.

And when we asked for discovery on this, we got a number of complaints and pieces of information from them about people calling Apple and complaining about this change. We got a lot of Government entities emailing Apple saying you can't make this change. We've got business entities emailing and saying you can't make this change.

But a more important one to the issue we are here in front of you, Your Honor, today is, one of the Apple Customer Care guys -- and it is this next slide, and I'll do my best to read it to Your Honor because it is not as clean as I would like it to have been -- the client says: I believe Apple is very secure, and that's why I am so concerned about this --

in reference to the change about VPN on Demand. They are making a change to something they had over the other guys and for money. It didn't say they were making the change because it was more secure. It said because of the lawsuit. And that makes me very, very upset.

And the agent says: Yes, I understand. From what I understand, Apple was sued and lost the lawsuit. Because of that we were forced to change how VPNs worked temporarily.

So now their agents are telling their customers that the change they are now seeing is temporary. And so that is kind of -- gets me to the next issue with the Court is that they are going to say we are going to make the change. Because we are going to make the change, Your Honor should give us a lower royalty rate.

I would suppose that once the lower royalty rate was given, they may change back to infringing. That is because that is not the purpose, in our opinion, of these changes. These changes are band-aids meant to put them in a better positions for appeal and for the argument here in front of Your Honor; and they are not truly meant to be design-arounds of any real temper.

But let's assume they are good design-arounds. Let's assume that they are going to use them. They are irrelevant is what I would tell Your Honor. If they have

design-arounds they can go to for the purpose of assessing a royalty, I would say to Your Honor they are irrelevant.

Because if they have a choice in the matter, then the rate for using it should be irrelevant to them. It shouldn't matter. They should have moved to their new feature, and the rate applying to infringing products should not be reduced because they have an option.

The reason for that, Your Honor, is in the hypothetical negotiation in the past, you didn't have a choice. We are talking about a hypothetical -- we go back in time. We say they could have done something else if they knew they were infringing. That is why you go back and you make it a stopgap in the back for saying it would have been 5 million to design around, 5 million is your damages.

But in the future since that day of that verdict, they had a choice and they made it. They have to live with it. They chose to use the feature. They chose to continue to use the feature. That is where they lived, and they have got to pay for it. The point they are trying to make now is because we have a non-infringing alternative, we would like to eat our cake and have it too. We would like to have a lower royalty, so if we chose to go back to that, we would have a lower royalty. And we want to use our design-arounds to argue that is why we get to go over there.

But the reality is, if you have a design-around,

get to it. The rate should be higher. If you don't have a design-around, the rate should be higher because you can't get off -- avoid this technology. And I think the reason why that position is different than it is for the past, is, again, because someone in the past didn't have the choice to change their behavior. Someone now does.

And so the scenario if you were in a true negotiation with Mr. Larson and Apple sit down at a table and they talk about this, and Apple says it is going to take me a year to get off of your feature but I'm going to get off your feature, I would assume that Mr. Larson would say you are going to pay for that year you are on my feature, and I'm not going to get you -- you are not going to get off easy because you couldn't get off early. You have got to pay for using the feature. You have to pay what other people have paid. That is where it goes back to the fundamental fairness issue.

So, Your Honor, I have got some cases here. I believe many of these are from some of your cases, Your Honor:

It is wrong as a matter of law to claim that reasonable royalty damages are capped at the cost of implementing the cheapest available acceptable non-infringing alternative.

That is in the DataTreasury case. I believe that one was Folsom.

The next one, Affinity Labs: It is hard to

predict the exact duration of Apple's ongoing infringement. The fact that Apple may be able to quickly cease their infringing conduct, actually supports the imposition of a higher enhancement. A higher ongoing royalty will not be especially harmful if Apple can quickly be free to the obligation to pay it.

Then I have one more, Your Honor. It is from Affinity as well: On the other hand, should Apple choose to continue its ongoing infringement for the life of the patents despite the alleged availability of the non-infringing alternatives, its culpability level would be high, which would support a higher enhancement.

Your Honor, the reason I kind of harp on this is because it does sound a little odd compared to the past hypothetical negotiations. But like I said, the reality is you have the choice now.

We are not in the time of, gosh, if I only knew back then, I would do something different. You know now, and you can do something different. If you want to, you can do it. Otherwise, you have to pay.

So with that, Your Honor, the request that VirnetX has in this case is that the royalty rate be 1.52 percent for products past the verdict. That comes out to, based on an average selling price of the smallest saleable unit of the iOS devices, it comes out to $6.49 a device for iOS, and

it comes out to 44 cents per Mac computer.

Now, Your Honor, I gave you this other slide, the next slide in your deck, in case you wanted to do the arithmetic, here this is the average price. It is 4 dollars -- 427 dollars for each iOS device is the average weighted smallest saleable unit, and 29 dollars for each Mac computer.

I gave that to Your Honor in case -- obviously, if you decided to go with a different rate, the 1.3 or some other rate, you have got this data to work upon if Your Honor was interested in applying a cash price instead of a percentage price.

I have got one more thing. I want to show you this quote, Your Honor. I think this is important. It is from Your Honor's ruling -- I read it just -- I guess it was two months ago: The Court must consider the change in the legal relationship between the parties to avoid incentivizing defendants to fight each patent infringement case to the bitter end, because without consideration to the changed legal status, there is essentially no downside to losing.

And, Your Honor, that is what I am saying is happening here. They told the jury one thing. They got a royalty rate -- and I'm not being negative about that royalty rate. I'm just saying they got the royalty rate they did, which was much lower than we proposed as a royalty in the case, and they did it based on misinformation. And to allow them to

walk away with that same rate, is a scenario they get to walk away in a better position than anybody else was.

And they did it because they fought to the bitter end, and they are going to fight to the bitter end. And what is going to keep them from going back off these non-infringing alternatives?

Your Honor, that is the majority of my argument. I do have one thing I want to refer to real quickly because I believe it will come up. Apple argues that the jury must have stacked the royalty in this case -- or actually they don't argue that. They say that Vellturo suggested -- their expert suggested his royalties would be stacked. So for VPN on Demand, it is one royalty; for FaceTime it is another. And in some cases those stacked on top of one another.

So they are arguing that when one of their non-infringing alternatives gets implemented, that they should get the rate cut.

And I bring that up, Your Honor, because it is very important. The rate that the parties agreed to in this case is based on Mr. Weinstein's analysis. So the .52 percent is based on taking Mr. Weinstein's number and applying it to the jury verdict. And that is where the .52 percent comes from. It is not from taking Apple's expert, whose analysis was much different.

Both parties agree on the .52 percent. The

reason why that is important is Mr. Weinstein did not stack the royalties. Mr. Weinstein conservatively in this case applied a rate that said whether it is one feature or two, you are going to pay the full rate. That is what Mr. Weinstein did.

And since we are talking about Mr. Weinstein's rate, that is what should apply. It should not be a scenario where you get to pick and choose and cut the rate in half just because you took one feature out or another, especially given the fact that we are all starting from Mr. Weinstein's analysis in this scenario we are talking about.

It was the one thing that Mr. Williams actually agreed to in the very first part where I had my three bullets was that we were starting with that .52 percent. And that comes from Mr. Weinstein's analysis, and he did not stack.

But also just for Your Honor to see, you know, Mr. Weinstein independently proved up his numbers based on either VPN on Demand or FaceTime. That is what this quote here is. I think that is on my direct. If the jury determined that only VPN on Demand infringed, what would the damages be? The damages would be 703 million dollars.

And so, Your Honor, that number is the number minus three million dollars in damages for the Mac operating system products because they didn't have VPN on Demand in them.

My point in showing you that is to say our total ask was supported by either feature. It was not a stacking of

the features in order to get to that amount. So it is important when they argued we should cut the rate in half whenever the -- when one non-infringing alternative may have been implemented we should cut the rate in half, that is inappropriate based on the way the analysis was done in this case.

And more importantly, Mr. Vellturo agreed, he says: It is entirely unclear whether the jury applied an implicit or explicit royalty rate for both the 504 and 211 or the 135 and the 151, what it viewed as the smallest saleable unit corresponding to each product or how it computed damages.

And the point of this quote is that Mr. Vellturo said he has no idea how the jury computed it, but we are all relying on Mr. Weinstein's analysis to get to our number. And more importantly, Your Honor, is that any doubts with regards to whether or not there was stacking here -- any doubts regarding the ongoing royalty amount should be resolved against the infringer.

Apple is the infringer in this case. Their own expert can't say the jury is stacked, and that should weigh in favor of VirnetX because VirnetX is the analysis we are all using. It wasn't stacked. And that is the reason why we think it is not appropriate to cut it.

But even if Your Honor was to cut it based on a scenario where Apple designed around one feature versus

another, I would tell Your Honor, the jury trial did not -- it was not a 100 percent of the products do both features, which means a 50 percent cut when you take a feature out, is inappropriate.

A large portion of that model or the models in the case were VPN on Demand phones like an old 3G or 3GS, these are devices that didn't have FaceTime. So, therefore, they didn't get hit with two royalties. So a .52 percent cut in half, that is just mathematically wrong to cut that rate in half in order to get to a one-feature royalty rate.

So with that, Your Honor, I will go ahead and concede the floor to Mr. Williams. Thank you, Your Honor.

THE COURT: Thank you.

MR. WILLIAMS: Your Honor, let me start with a point that we started this hearing off on, and that is, what would be appropriately included? I think the reason that we are arguing about what should be included in a reasonable royalty award in terms of products is because if you look at what VirnetX is asking for, the way they frame it is they say essentially -- and this is not a direct quote from their papers -- but they say, essentially, anything running an iOS 3.0 operating system or later.

And the effect of that, of course, is there is no stopping point to the point that it would even include the products that have been released today and would, perhaps,

extend the products that are released next year and on and on.

What we are trying to do is say let's put a stop at some point on this, all right? Let's define specifically what is there. Let's not assume everything is going to go forward in the future infringing because the second point I want to make is the effect of what they are trying to do is shift to Apple a burden of showing non-infringement of some new design.

And we know from the case law that even in the ongoing royalty context, that is inappropriate. The burden is on and remains on the patentee to show infringement.

So I believe that the parties can work this out, and we will be able to submit something to the Court in terms of what products will be included. I truly believe we will be able to do that. So I think it is going to become a non-issue, but I just wanted to point out to you why I believe, in fact, there is an issue; and that is because of their complete open-endedness in terms of what they are trying to incorporate.

Okay. Go ahead.

Now, as I see it here, there are two basic issues that need to be addressed. And one is -- well, let me first say that the parties agree on two points. The two points they agree on for sure explicitly from their papers is that a hypothetical negotiation would have taken place March 1st of 2013. That is the day after the judgment was entered.

And that hypothetical negotiation would have been conducted to determine what would be the royalty going forward from the date of the judgment.

The second thing that we agree on explicitly is that what you look at -- the focus on that analysis is on changed circumstances. So you would look at what new evidence, for example, would tend to push up or push down the royalty that the jury found because the case law tells us that what the jury found is a good starting point to decide what the post-judgment ongoing royalty should be.

Your Honor, I don't know if this mic is cutting out. The speaker seems to be cutting in and out on me.

THE COURT: It does. You might just try adjusting it. Maybe you are a little too close to it. Sometimes it does that.

MR. WILLIAMS: All right. So, again, we agree the reasonable royalty date is March 1st of this year. We agree you focus on the changed circumstances; and that should be determining -- those are the factors to consider in determining what would be the reasonable royalty, and that is the changed circumstances. So I think that is the best place to start.

Now, there are going to be two issues I want to talk about, first of all. I want to talk about what circumstances, in fact, were representing changes as of March

the 1st of this year and in particular things that the jury did not consider that are rolled up into its determination that .52 percent effectively was the rate.

And the second thing I want to focus on is this notion that because Apple was adjudged to infringe these two features, that they should thereafter be automatically, and I believe the word that he used was absolutely willful. So that is the second issue that I want to touch on.

In fact, I think the issue of Apple's willfulness, if any willfulness is involved, is another one of these possible changed circumstances that should be taken into account in determining what the ongoing royalty post-judgment should be.

Next slide.

So as I said, the parties agree on the March 1st hypothetical negotiation date; and that you must account for and take into account the changed circumstances. In fact, that is the focus of this hypothetical negotiation.

So I think the place I want to start is let's look at that date. What circumstances, in fact, have changed relative to a prior negotiation and in particular focusing on evidence that the jury did not have when it decided effectively that the rate for two features infringing four patents was .52 percent.

Now, just as an aside, the .52 percent is not

Mr. Weinstein's analysis. That is what comes from the jury deciding that two features infringed four patents. That is what that number comes from, in fact.

So at the time, March 1st of 2013, at that time Apple had signed an agreement with Akamai to provide relay servers, services for 100 percent of the FaceTime calls because if you will remember -- and the last bullet point goes to this, and the Court even incorporated it in its final judgment, that VirnetX concedes that this feature of FaceTime does not infringe if calls are routed through a relay server because there is no direct communication through a relay server.

So Apple on March 1st of this year had signed an agreement with Akamai to provide relay services for 100 percent of FaceTime calls.

Apple had developed the code which was going to be run on the servers that were required to implement this 100 percent relayed FaceTime calls as of this March 1st date. That code was up and running at that time.

Akamai was in the process of staging this additional server capacity to Apple as of March 1st. So the number was going up from whatever calls were relayed. It was escalating toward 100 percent as of March 1st.

As of April the 5th of this year, Apple had 100 percent of FaceTime calls went through the relays. So as of March 1st there was major changed circumstance relative to the

prior situation; and that is, that Apple was in a month and five days of no further -- admittedly, no further infringement of two of the four patents. So one of the two features was dropping off the scene within a month.

THE COURT: Let me ask you this, Mr. Williams: What is your response it may be dropping off the scene at what cost to Apple in your response to plaintiff's Counsel's arguments about the differences between the non-infringing use testimony at trial, the injunction, and later -- and what, according to plaintiff, the discovery is showing is an increasing monthly cost?

MR. WILLIAMS: Well, of course, everything that he gave falls within -- along those lines falls into one of two categories: Pure speculation, that is, what it is going to be many years down the line. And, two, projections, either projections by Apple or Akamai. But, again, what is going to happen in the future? And we don't know for sure what is going to happen in the future. We really don't.

I will say this; that there are certainly possibilities that Apple will be able to decrease its reliance upon relay servers without infringing. So I want to make sure that what we are clear on or the Court is clear on here is just because a call may not be relayed -- let me make sure I say this right.

To make sure that a call -- just because a call

is not relayed, does not mean it is infringing. I hope I made that right.

THE COURT: So you are saying there may be another non-infringing alternative that you are considering for the future other than the relay non-infringing alternative?

MR. WILLIAMS: Absolutely. And I will represent to the Court that obviously, I mean, Apple continues to redesign and change features in its phone. And it does not exclude VPN on Demand or FaceTime. So I just want to make sure that that is clear; that there is not going to be a going back, if you will, to what was adjudged infringement.

THE COURT: Do you agree, though -- I mean, I believe those were Apple documents that show this initial contract for 50 million dollars for 20 months. I believe that is what it was. So about two-and-a-half million a month; is that correct?

MR. WILLIAMS: Your Honor, I had done a different calculation. I thought it was lower than that, but I don't know for sure whether that is correct or not. By my calculation it was somewhat lower than that, but I am not going to stand up here and quibble at that point. But I will say that let's assume it is the 2.4 million a month, they want a million dollars a day.

So the 2.4 million a month would be significant downward pressure on a royalty of one million dollars per

day.

THE COURT: So you are saying that based on the volume at their 1.5 percent, that would relate to one million dollars per day.

MR. WILLIAMS: Roughly. And the reason I say that is because -- I have a slide up here right now -- is the Court awarded a post-verdict pre-judgment royalty of approximately $300,000 a day. I think it is slightly more than that, actually three thirty or something to that effect. They essentially want that trebled. I think it was three thirty if I am not mistaken, but the record will reflect exactly what that was.

They want that trebled. So they are looking for a million dollars a day. And what we would submit is that let's assume the 2.4. I think it is actually lower. But let's assume 2.4. That represents a significant down pressure -- downward pressure under a George-Pacific analysis, on a royalty as compared to one million dollars per day.

And, again, we are looking at March 1st of 2013, what are the circumstances? So Apple would have had that information.

Now, if Apple didn't have the information before, sobeit. The relevant inquiry that both parties agree to is that March 1st is the date. March 1st is the date that we look at.

So let's assume 2.4. That represents a significant down pressure and in fact --

THE COURT: Let me ask you, though, to comment on what they -- and I thought that graph that they showed through 2014, was that an Apple graph or was that a plaintiff's graph?

MR. WILLIAMS: I don't know, Your Honor. I hadn't seen it.

MR. CASSADY: Apple. Apple, Your Honor.

THE COURT: I would like you to respond to that graph.

MR. WILLIAMS: Again, like I said, it falls into one of two things, either speculation or projection. It is one or the other.

THE COURT: Don't you think projections have some relevance to the Court, I mean, especially if they are Apple's projections?

MR. WILLIAMS: Oh, I certainly think they have some relevance; but the question is would Apple continue along, truly, along that path if they saw -- if management saw that and said we are not going that route. We will do another non-infringing route. Right? So that assumes there is no other change. Like I said, I can tell the Court now that they are, in fact, looking at other alternatives.

THE COURT: Other than them looking at it, do

you have any evidence of any other non-infringing alternative at this time other than the relay?

MR. WILLIAMS: None that I can submit to the Court, Your Honor.

THE COURT: Okay. Thank you.

Go ahead.

MR. WILLIAMS: Can we go back to slide -- about 3, I think it is. This next slide then.

So the circumstances as of March 1st --

Is the next slide, Matt? Back me up one slide. There we go. Yeah, this is where we were.

As of March 1st the FaceTime design-around, this would have been the situation. They were asking for a million dollars a day. The post-verdict amount award was I think actually 330,000. And the payments to Akamai which they have shown to be over the next 21 months, which they say is 2.4, is a fraction of either one of those numbers.

So that fact alone, that change alone would have represented downward pressure on the ongoing royalty. And, again, Apple is working toward its VPN on Demand design-around in the fall. And they knew that as of March 1st. In fact, both parties did.

Go ahead, Matt.

Another changed circumstance as of March 1st, and that has to do with the reexamination. And he said I was

going to raise it, and I absolutely am going to raise it because that is a changed circumstance that the jury was unaware of.

Relative to the first hypothetical negotiation, as of March 1st of this year the PTO had rejected all claims. In fact, those reexaminations at this point, two of them the prosecution has been closed and the other two are about to be closed. So we are about to start the appeal route in the Patent Office on those right now. So Apple would have known that and so would VirnetX. So that fact would also represent a changed circumstance which the jury did not have in their pocket.

And Apple has also filed some IPR's, which are interparties reviews, on those patents as well.

So go ahead, Matt.

This is very briefly -- this is the status -- well, I think we have submitted this to the Court for its edification and information, but this is the reexamination status which shows where things stand on those cases right now.

So the changed circumstances represent the design-around activity and the recognition that their claims, in fact, have all been rejected. Not just asserted claims on those four patents but all claims on those four patents.

Now, let me take an aside for a minute, a tangent. That is, Mr. Cassady says that we have run into some

problems in trying to implement some design-arounds. And let's throw in this business of VPN on Demand and FaceTime with the relay servers.

The reason that we have run into problems, Your Honor, is because we are trying to design away from what was adjudged as infringing. If we were standing on our hands and saying, VirnetX, we don't care about this jury verdict, we are going to continue on -- like in the Affinity Labs, the quotation that he read for us awhile ago. That is, if the defendant there chose to continue infringing for the life of the patents, maybe that is an indication of willful infringement.

The problems we ran into were encountered why? Because we were moving. Did we encounter other problems and issues. We have encountered issues in trying to implement things. But we have cleared the hurdles on the FaceTime. And Apple intends to clear that hurdle this fall on the VPN on Demand.

But the fact of the matter is we have continued to move and we have been moving, which represents truly an effort to get away from what was adjudged to be infringing. And I submit to the Court that suggests, at least as far as those factors are concerned, Apple is not a willful infringer; and that the rate that the jury itself came up with -- not Mr. Weinstein -- should be continued on the ongoing royalty basis

subject to potentially downward pressure and subject to the implementation of the design-around of the FaceTime product.

So here is basically the second position, the second point I want to argue. That is, whether it is appropriate once a defendant has been adjudged to be infringing, he should be automatically or absolutely willful from any infringement thereon.

I submit to this Court that the proper way to view that is that any continued activity should be viewed in its totality to determine whether any continued activity and to what extent makes that infringer a willful -- that adjudged infringer, a willful infringer.

And I am quoting here from the Presidio Components case in the Southern District of California. In this case, Your Honor, you determined that no injunction was appropriate in this case. VirnetX failed to show entitlement to injunction. And here is what this Court said in that scenario:

Where an injunction is found to be improper -- as is true in our case and was true in the Presidio case -- quote, the Court is hard-pressed to find in what material respect the situation is different than it was at trial. In determining the reasonable royalty rate, both parties assumed the patent at issue was valid and infringed.

So, in fact, that is an assumption that is not

uncertain. At the first reasonable royalty the parties sat there and hypothetically Apple would have known it was infringing valid patents and that it, in fact, needed a license.

So the Fresenius case that I quote here is one that says: The jury award is the significant starting point in setting the ongoing royalty rate, absent changed circumstances. And that is why we focused on the changed circumstances.

Next slide.

Now, VirnetX argues that this assumption of infringement at the first hypothetical negotiation is somehow strengthened or reinforced by the jury verdict. But that is -- if you think about what the law is on that, that is just an incorrect statement of the law because infringement at that hypothetical negotiation is, in fact, assumed without uncertainty.

The parties are not at liberty -- in fact, the expert sat on the stand and told the jury this. So the jury made its determination under the assumption that Apple was, in fact, infringing; and valid patents.

So that finding does not change the relative positions of the parties with respect to a hypothetical negotiation because that assumption was already being made and not on some -- there is not some sliding scale, if you will, of an assumption that you are infringing a valid patent. There is

not a weak assumption and then a stronger assumption and so on and so forth.

Now, we can certainly look at cases where continued activity after infringement, resulted in an enhanced award. And I do believe that the Court should look at all of the circumstances to determine whether infringement is willful. But I do not believe it is a correct application of the law to say once you are adjudged, that somehow strengthens this assumption of infringement in a hypothetical negotiation such that you are absolutely willful.

But even if you apply their reasoning, if you apply their reasoning, then the finding that the asserted claims by the Patent Office are all invalid, would likewise undermine the presumption of validity.

So if these activities by the jury somehow heighten an assumption of infringement, then it would work the other way as well; that is, the subsequent finding by the Patent Office that the claims are invalid would undermine the presumption of validity.

I would submit that is not really the way that the hypothetical negotiation under George-Pacific should be structured.

Okay. Next slide.

Now, let's talk about what VirnetX has done. So what we have shown here is that all of the relevant factors

basically point to downward pressure on the starting point or the reasonably royalty.

Now, as you are going to see, we are not suggesting that the Court start at a lower royalty. We are saying the .52 is effectively -- that is the effective rate the jury itself awarded, so as the case says, we will start there. And we are suggesting that would be the appropriate rate from March 1st to April 5th of this year. And I will get into that in more detail in just a moment.

But VirnetX's methodology is not what George-Pacific would dictate. They suggest by submitting a declaration of Mr. Weinstein, that he has done a George-Pacific analysis. But, in fact, it admits that what it has done -- and we saw it in the slides today -- is they averaged just a simple averaging of selected VirnetX licenses. Not all of VirnetX's licenses but selected VirnetX licenses.

In particular, we didn't hear anything about Microsoft in the opening argument. Why? Because Microsoft paid a much, much lower rate in similar circumstances to what Apple was in the post-judgment phase.

So a simple unweighted averaging of these rates for license amounts that are orders of magnitude --

THE COURT: What was the Microsoft rate?

MR. WILLIAMS: The Microsoft rate was disputed between the parties; but according to Mr. Weinstein, their

expert, it was .24 percent.

Now, Mr. Vellturo -- and he explains this somewhat in his declaration that we submitted in connection with these papers, and I submit that gives a great synopsis of this; but Mr. Vellturo said, well, the problem with Mr. Weinstein's analysis is he did it on sort of worldwide basis; whereas, it is appropriately .115 -- I think was the number .115 percent was Microsoft. A large company had been adjudged an infringer. In fact, negotiated a license. And those were the terms of the license.

So a simply averaging -- unweighted averaging of these small amounts that are orders -- like I said orders of magnitude less than the amount that Apple would pay, can't be a correct tie to what the damages or reasonable royalty, in fact, ought to be.

Now, Mr. Cassady handed up to you what the rate was for the most recent license with Avaya. And I think we have seen their calculation on their slides as to what the -- basically, their average of these other rates were. And it is in the papers. Each of these license rates I think is spelled out in the papers, if I am not mistaken.

THE COURT: What is your response to the Avaya license?

MR. WILLIAMS: My response to that license and all license -- let me make it specifically as to Avaya at this

point.

The Avaya license is set up such that I would say -- and I think future is going to bear me out on this one -- it is highly unlikely VirnetX will ever collect a future royalty under that license beyond -- any future royalty. They took some upfront money.

The reason I say that is because it is set up very similarly -- well, first of all, it allows a significant percentage -- I will just leave it at that -- a significant percentage of increase every single year before there is any royalty due at all. And by that I mean increase in sales, a significant increase in growth; and there is still no royalty due.

It is not so different from the other licenses, and I have got numbers that VirnetX has reported to us for ongoing royalties that they have collected under all these licenses, and I would very much like to pass that up to the Court. These are the numbers that they have reported to us that they have collected ongoing royalties. I will show it to them first.

THE COURT: All right.

(Pause in proceedings.)

(Shown to Counsel. Shown to Court.)

THE COURT: Also, just for the record, I am going to mark but have it sealed, the document Mr. Cassady

handed up earlier. I'm going to mark it as Avaya License Plaintiff's Exhibit No. 1, and then I will mark yours as Defendant's Exhibit No. 2.

Excuse me, are these dollar amounts that you have handed me up?

MR. WILLIAMS: Yes, sir. And those came from reports that VirnetX has produced to us that show the reasonable royalties they have received. If the Court would like, I can post to the Court copies of those reports. But that is the numbers that came from the reports.

THE COURT: That's all right.

MR. WILLIAMS: So if you look at those numbers, Your Honor, you'd say, should I really be considering these licenses for any of the reasons that Mr. Weinstein wants me to; commercial success -- I mean, we can look at those numbers -- comparable to Apple. I think it has been made of record in this case what the Microsoft license was and the amount of money involved.

These are -- let's just leave it at quarters of magnitude smaller than these licenses. Not only that, these licenses were considered by the jury when they decided to award effectively .52 percent.

So if you look at what VirnetX is doing and what Weinstein is doing, he is averaging and saying this average is the rate the parties would have agreed to on March the 1st. In

effect what he is saying is the jury got it wrong because he is now saying that that average is what the parties would have agreed to on March 1st. He didn't even submit that. He submitted a one-percent rate at trial, and the jury rejected that.

So he is simply disagreeing with what the jury found to be the reasonable royalty in submitting his average, and I submit that he --

THE COURT: What is your response to Mr. Cassady's argument that the jury made that award because it was -- certain things were misrepresented such as the five million dollar cost for a design-around when it is, according to Mr. Cassady, at least 20 and moving skyward?

MR. WILLIAMS: Well, I would say two things. One, he has no idea what the jury based its award on. But one thing we can know is the jury didn't take that. They didn't accept either parties' numbers. But he doesn't know. I mean, this is pure speculation. I think I have heard it called rank speculation. There is nothing worse a speculation as rank speculation.

But that is what it is, it is speculation. We can sit up here and speculate until the cows come home; and that is not going to help us decide what the royalty should be in this case.

What we do know is the jury awarded -- they were

instructed to award damages for the infringements. They found two infringements; FaceTime and VPN on Demand of four patents. And they awarded effectively a .52 percent royalty. I will come to this halfing in just a moment and respond to Mr. Cassady.

But that is my response. We don't know what the jury did. All we know is what they -- I'm sorry, we don't know what they thought. What we know is what they did. And what -- speculating on what they thought is not going to help us move down the road in determining what the royalty should be here.

The Siemens and Avaya licenses, I will grant you, were not before the jury, so they were not taken into account. But they are no different in terms of the royalty rate, so they are in the same range of royalty rates that the jury, in fact, did have with these other VirnetX licenses.

There is no reason to give those licenses any greater weight in this post-judgment phase because that information was considered by the jury in determining the .52 in the first place.

Go ahead, Matt.

So what would be a basis then for trebling the jury's effective rate, which is exactly what VirnetX wants? What they rely on is Apple being a willful infringer because we were adjudged to be infringing. But willfulness -- whether Apple is willful, like I said in the very beginning, is really

simply one circumstance to take into account or one consideration to make in deciding what the running royalty, ongoing royalty should be.

If you look at all of the evidence, the evidence of Apple's attempts and successes to design around and reexaminations and all of the efforts that Apple has put forward, I will submit to you that they are, in fact, not acting as a willful infringer would act. And there is no greater assumption of infringement after the jury has spoken than there would be at a George-Pacific hypothetical negotiation.

So if you look at the relevant factors, they suggest, in fact, a downward pressure on the jury's effective rate at the post-judgment hypothetical negotiation because VirnetX would be sitting there knowing they are about to lose one feature and two patents in the negotiation, so they would take what they could get.

Now, Mr. Cassady stood up here and said I think VirnetX would do this. I am here to say that I think VirnetX under George-Pacific tells us what they would do. And, that is, given a short extent of time, they would take a lower rate. That is what George-Pacific says they would do.

The actual implementation and the viability of that FaceTime design-around greatly reduces their negotiating power. Under George-Pacific if the term of the license is

short, that is downward pressure, not upward pressure on the royalty rate. That is what George-Pacific says they will do.

Go ahead.

Now, this goes -- I want to touch a little bit on what products ought to be included in any reasonable royalty. And so this first one basically goes to the question of getting into arguments about what is no more than colorably different.

All of those products that were not subject to the first case -- in fact, some of the products that were in the first case they have included in the follow-on case. But certainly all of the products that were not included in the first case, VirnetX has voluntarily injected into the second case. And I submit that those products ought to be looked at and thoroughly, fully vetted under that scenario.

There are changes coming on this iOS 7 that are currently being tested. Once things have been provided out and commercialized -- and this is the way the parties have operated from day one, I believe, in the discovery of this case -- we will be producing that source code. They have already seen the relay-only source code for the FaceTime. They have seen that and had access to that.

They voluntarily chose to pursue this remedy in this follow-on case, and Apple is simply suggesting that the Court ought to let that case play out and not include products

in this case that have not been adjudged to have been infringing, is basically what the Court did in the Fractus case.

What that would enable us to do, hopefully, is avoid satellite litigation. Like I said in the beginning, I believe and I am hopeful that the parties will be able to agree on what products ought to, in fact, be included within a reasonable royalty award.

Go ahead, Matt.

So the ongoing rate, whatever it is, should reflect Apple's complete design-around of the FaceTime patents as of April the 5th. There is no justification for continuing a royalty due to FaceTime after that day. Like I said, they have had that code. They have had the opportunities to inspect it if they believed it is somehow non-infringing -- I mean, infringing. They could have spoken up. Obviously, they conceded throughout the entire first case that calls made through the relays were not infringing.

There cannot be an economic justification for the notion that Apple would continue to pay the same rate for half the patents and half the features after April the 5th. You look at the George-Pacific factors. It tells us explicitly what the patentee will do. He will take a lower rate when fewer features and fewer patents are involved. That is the commercial reality of the situation.

The ongoing rate as of April 5th then should be no more than half the rate assessed prior to April 5th. Now, it should be no more than that. There were products, in fact, included in -- as FaceTime. Let's say the Mac computers, for example, that were only accused under the FaceTime feature but not under the VPN on Demand. So there should be no royalty whatsoever due on any Mac computers following April 5th of 2013.

Go ahead, Matt.

So in conclusion, the period of March 1st until April 5th because of what the jury did, the Court should impose the same rate awarded by the jury because the only circumstances that have changed since the original hypothetical negotiation, favor Apple. The FaceTime design-around, the efforts in designing around for VPN on Demand, which are coming, and the reexamination success.

Beginning April 5th that rate should be no more than one-half because FaceTime is admittedly not infringing beyond that date.

If the Court were, in fact, inclined to increase the rate because Apple has been an adjudged infringer rather than an assumed infringer -- and I, again, submit under the law there is no distinction between the two for George-Pacific hypothetical negotiation reasons -- the adjustment should be a small one and reflective of Apple's ability to design around

the patents.

Mr. Cassady stood up here awhile ago and argued that, well, you know, if they can design around, that justifies a higher rate. That is directly contrary to what George-Pacific tells us. The presence of a design-around, in fact, suggests the rate should be lower because otherwise the patentee runs the risk that this is going to be the design-around instead of taking a license and bearing the royalty.

I do want to address, because I think it is important, I suggested earlier that Apple continues to look at other designs not only with respect to FaceTime and VPN on Demand but its other products as well. I would say nothing is permanent, Your Honor. I think that goes without saying; that because something is temporary does not mean that they are going back to what was adjudged infringing. And I can tell you that Apple has no intention of going back to what was adjudged infringing. That does not mean we are not testing other things, other ways to design around. Quite likely we will implement some of those things in the future.

So all of those factors taken into account, we believe that the rate that the Court should award in an ongoing royalty would be .52 percent for the time from March 1st to April 5th. And thereafter it should be .2 percent. The parties I think will attempt and hopefully be successful in

deciding what products to submit to the Court on that.

Thank you, Your Honor.

THE COURT: Thank you, Mr. Williams.

All right. Any rebuttal?

MR. CASSADY: Your Honor, I will be short.

If I may approach, Your Honor, I have got the document that we relied on for the bandwidth projections, and it has got Apple's Bates number. I wanted to give it to you now.

In full disclosure, Your Honor, I haven't taken a deposition on these projections, so I know it has been produced based on a request I made months ago; and they gave it to us in the last two weeks. But the point is, this is either Akamai or it is Apple. And Akamai is their agent with regards to the relay. As far as I am concerned, it is Apple. But I wanted to make sure in full disclosure purpose to Your Honor that it may not be Apple itself who wrote it but Apple and its agent Akamai is writing this.

So if I could approach, Your Honor?

THE COURT: All right.

All right. We will mark this as Plaintiff's Exhibit No. 2 for the hearing.

MR. CASSADY: And then, Your Honor, just a couple of other points.

THE COURT: Let me ask, is there any objection

to that?

MR. WILLIAMS: Your Honor, I don't have an objection to putting it in. What I would ask, though, is that we be given an opportunity to go back to submit a very brief supplement just directly to this one document. It would be very brief and very quick.

THE COURT: All right. I will allow you to do that within five days.

MR. WILLIAMS: Thank you.

MR. CASSADY: Your Honor, just so you know, in the right front of that paper is projections -- the projection I was referring to is the very bottom right, 900 gigabits is one of the references there into 2014 like we were discussing.

If you look at the very last page, that is the graph that was in my slide. I want to make sure Your Honor understood what we were relying on. The very last page is the 2014 projections. There is a little green line at the bottom left that is the capacity they currently have, and they are going to have to increase it if they don't get off this relay method.

But the point of all that is whether or not those projections are entirely air-tight or in the ballpark, the reality is that what the jury heard was drastically different than what is the reality.

Some of the numbers got thrown out to you that

we are asking for a million dollars a day. I just did a quick number. What they told the jury was that their design-around was $6,000 a day. That is what they told this jury, five million dollars for about two years, $6,000 a day.

So I wanted to put in perspective that what they told the jury was so drastically different than what the reality was. That is our point, Your Honor, is that they told the jury a much smaller number.

At the end of the day you get one juror who is invaded with thinking this Apple, they are innovative and they can do whatever they need to do and they are telling you it is five million dollars, you know, Apple is a very popular company. I can see a juror very easily believing that.

Am I saying I am clairvoyant and I know they did that, absolutely not, Your Honor. But the point is this false information through no fault of VirnetX's was put in front of this jury, and I don't think Apple should be able to flaunt the jury system, say what they want in front of the jury, and then come out later with information that now helps them by saying how detrimental the design-around is.

Then, finally, Your Honor, what I will say is the royalty rate that all of the parties agree to is .52 percent. I think it is very important to understand that came from Mr. Weinstein's number.

The way that the .52 came was you took the 709

million from Mr. Weinstein's number, and you got the relationship of that number to the number that the jury gave. That is what we are all here talking about today. We are not talking about the number as of Vellturo's up to the 368. We all agreed we are talking about the 709 down to 368, which is about 52 percent.

And Mr. Weinstein's analysis was a 1 percent royalty in the case. So if you go down to 52 percent, you are looking at 52 bases points and .52 percent in a royalty.

Why that is important is Mr. Weinstein didn't stack. Mr. Weinstein didn't -- he conservatively didn't ask for double royalties on these features, and he independently proved up the infringement damages for each feature.

And now Apple wants to start at .52 and go down, which I'm not sure I have ever heard another defendant say -- Your Honor, you obviously have more experience than I do with what defendants say when it comes to royalty. Maybe other defendants have said lower. But it has been pretty well-established law that you take the rate from the jury and go up after verdict.

That is what we are asking Your Honor to do is to take the rate the jury gave and go up. But we are also asking Your Honor to deal with the misinformation that was provided the jury that they can't possibly have understood the misinformation with regards to that relay server and the fact

that the design-around for VPN on Demand was supposed to be a matter of two weeks by an engineer. I believe that was the testimony at trial, two weeks by an engineer.

We are months past a verdict. We are seven updates, seven updates of iOS past the verdict; and they still haven't put out this design-around they keep talking about with regards to VPN on Demand. If they can't put it out in that amount of time, clearly it is more than two weeks engineering time, part one. And, part two, why would somebody as of March 1st have any understanding that Apple was actually going to design-around when 20 days after making the announcement they said they weren't going to do it anymore and started telling customers, our bad, we are not going to do it? It is just temporary if we do do it.

THE COURT: Good. All right. Thank you.

Anything further, Mr. Williams?

MR. WILLIAMS: Very briefly, Your Honor. I want to address this quote, unquote, misinformation thing. That is, that was -- to the extent there was any, quote, misinformation given to the jury, they, in fact, addressed that at trial.

I don't know if you will recall but they had their guy do -- in fact, they had my witness, as I recall, on cross-examination they led him through and say what if you assume a certain amount of traffic through FaceTime so that amount of relay service would have cost you 720 million

dollars; isn't that correct? That is exactly how they addressed -- they addressed that very issue in trial.

So to give the one side of the story and say -- speculate as to how that might have skewed something, is to ignore what they, in fact, did at trial and it was addressed that very situation.

To speculate that the jury did or did not stack based on what Mr. Weinstein did, George-Pacific tells us how to do this process. I submit that is what they are ignoring.

THE COURT: All right. Thank you both very much for your excellent arguments. I will get you a ruling as soon as I can.

We will be adjourned.

(Hearing adjourned.)

CERTIFICATION

I HEREBY CERTIFY that the foregoing is a true and correct transcript from the stenographic notes of the proceedings in the above-entitled matter to the best of my ability.

/s/ Shea Sloan
SHEA SLOAN, CSR, RPR
Official Court Reporter
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